Croatia

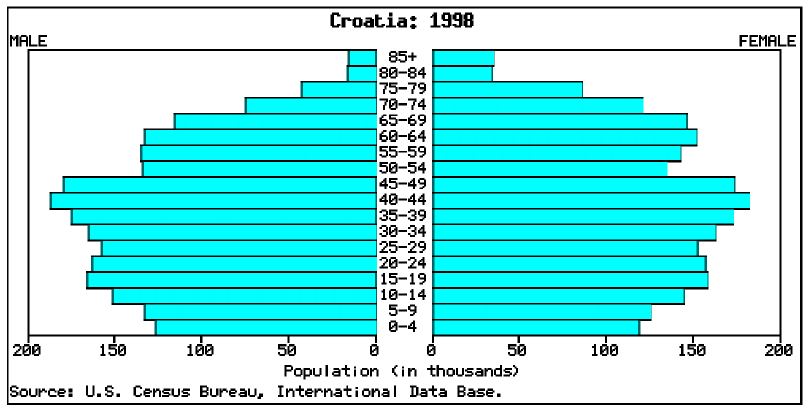
Summary of Current System			
	Pillar 1	**Pillar 2**	**Pillar 3**
Type:	♦ Defined-benefit		
Participation:	♦ Mandatory		
Management:	♦ Publicly-managed		
Financing:	♦ PAYGO		
Coverage:	♦ Working population		
Eligibility:	♦ Age 60 (men) or age 55 (women) and fulfilled minimum contribution period		

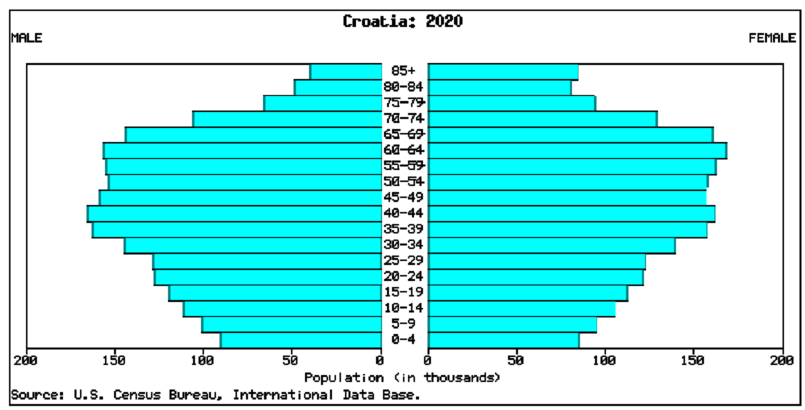
Challenges Facing Pension System

- ❑ Demographic shifts
- ❑ Financial viability of pension fund

Summary of Current System

The current system in Croatia operates is a pay-as-you-go (PAYGO) financed, defined-benefit system. This public system provides old-age, disability and survivor benefits to the working population. In addition, separate systems have been established for self-employed workers and agricultural workers. The Pension and Disability Insurance Fund operates the pension system. Funding comes from mandatory contributions from both employers and employees. Equal contributions from employers and employees total about 21.5 percent of payroll. The government provides funding if the pension system incurs deficits.





Two minimum conditions must be fulfilled to receive benefits. First, employees must reach retirement age, which is at least 60 years for men and 55 years for women. Second, employees must have worked for at least 20 years to qualify for benefits. Early retirement is available to male workers who have reached 55 years and have contributed for 35 years, and female workers who have reached 50 years and have contributed for 30 years.

Pension benefits are based on an employee's 10 highest consecutive years of earnings. Men receive benefits that are at least 35 percent of average earnings plus an additional 2 percent for each year of contribution. For women, benefits are at least 40 percent of average earnings plus an additional 4 percent for each year of contribution. The maximum pension for both men and women is 85 percent of average wage. Early retirement benefits are reduced by 1.33 percent for each year below the retirement age. When an individual reaches retirement age, full retirement benefits are then available. Benefits are adjusted to reflect changes in average earnings.

A minimum pension is provided on a means-tested basis for low-income individuals. Finally, merit pensions (where pension benefits exceed the amount justified under their contributions) are available to certain groups, such as families of war victims, veterans and retired members of parliament.

Challenges Facing Pension System

Several factors have initiated the reform of the country's pension system. Like many countries in Eastern and Central Europe, the population in Croatia is aging. About 18 percent of

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SELECTED INDICATORS		
Demographic	*Year*	
	1998	*2020*
Total Population (in thousands)	4,672	4,469
Life Expectancy at Birth (Years)	73.75	78.34
Total Fertility Rate (Child Born per Woman)	1.54	1.32
Age Dependency Ratio (percent)	33.5	49.0
	1980-2000	*2000-2020*
Average Annual Rate of Population Growth (percent)	0.1	-0.2

Source: U.S. Bureau of the Census. International Data Base.

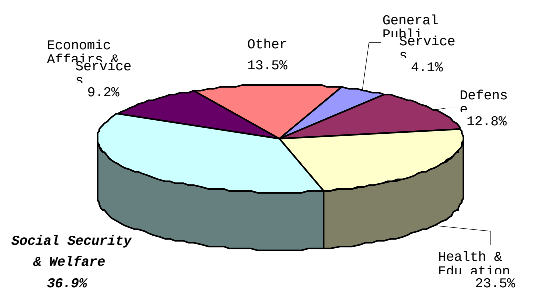
Economic	*1996*
GNP (PPP in billions)[1]	20.5
GNP Average Annual Growth Rate, 1995-1996 (percent)[1]	4.6
GNP Per Capita (in PPP)[1]	2,790
Inflation Rate (percent)[2]	3.5
Labor Force Participation Rate (percent)[3]	47.0
Unemployment Rate (percent)[4]	13.0

Source: [1]World Bank; [2]IMF; [3]International Labour Office; [4]Central Intelligence Agency.

Pension	*1997*
System Dependency Ratio, 1996 (percent)[1]	54.3
Employee Contribution for Pensions (percent of earnings)[2]	10.75
Employer Contribution for Pensions (percent of payroll)[2]	10.75
Public Pension Expenditures as % of Government Expenditure[3]	25.8
Public Pension Expenditures as % of GDP[3]	11.6

Source: [1]IMF (May 1998); [2]U.S. Social Security Administration; [3]IMF (September 1998).

GOVERNMENT SPENDING BY SECTOR, 1997



Source: International Monetary Fund. Government Finance Statistics Yearbook, 1997.

the country's population were over 60 years old in 1990 and will increase to 27 percent in 2020. The old-age dependency ratio is expected to increase from 36 percent in 1990 to 41 percent by 2000 and to 68 percent by 2035. This was caused by both the increases in the elderly population and by declines in the fertility rate. Projections indicated that substantial increases would need to be made in the contribution rates in order to support the increased cost to the pension system. Estimates indicate that the current contribution rate of 25.5 percent would need to be increased to 32 percent by 2010 and 44 percent by 2035 to maintain system solvency.

Pension Reform Efforts

Pension reforms to establish a multi-pillar system were presented to parliament in September 1997. The legislation has passed two readings, and a third and final reading is expected by the end of 1998. The enacted legislation will be effective in early 1999. The legislation contains the framework of the privately managed second and third pillars. Implementing legislation will however be needed to create a regulatory framework for private pension funds in these pillars.

Workers over 40 years old will remain entirely under the reformed (PAYGO) public pillar. These workers will continue to place the entire contribution of 21.5 percent into the public pillar. Reforms to the public pillar include changes to the eligibility criteria and the calculation of benefit levels. The retirement age will increase to 65 years for men, and 60 years for women. This change will occur gradually with the retirement age increasing by six months every year until the new retirement ages are reached. Early retirement ages will also increase by 10 years (to 60 years) for men and 5 years (to 60 years) for women. Early retirement age will increase annually by one year and calculation of pension benefits will be based on entire employment history rather than ten consecutive years of the highest salary.

Individuals less than 40 years old will participate in the mandatory, privately managed scheme (Pillar II). It is intended that at least 5 percent of the mandatory contribution will be re-directed to the second pillar. These workers will receive benefits based on their contributions to the first pillar and their accumulated contributions to the second pillar. Little has been decided with respect to the third pillar. There are suggestions that private pension funds operating in the second pillar also be allowed to offer voluntary private pension schemes.

The transition costs associated with the transfer of contributions to the second pillar are projected at 1.1 percent of GDP during the first year of implementation. The government is considering covering these transition costs through issuing government securities, using revenues from the privatization process, or a combination of both. Under the privatization process, the Pension Fund holds shares in former public enterprises. Furthermore, about 30 percent of the sale of publicly owned enterprises will be set aside for pensions, as legislated in the Privatization Law of 1995.

Pension Reform Efforts by Pillar

	Pillar 1	Pillar 2	Pillar 3
Papers issued on state of pension systems	✓	✓	✓
Formulation of proposals	✓	✓	✓
Development of draft legislation	✓	✓	✓
Introduction of legislation by parliament	✓	✓	✓
Review of legislation by parliament	✓	✓	✓
Passage of legislation by parliament	✓	✓	✓
Implementation of legislation			